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The President's Daily Brief

December 20, 1974

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At Annex we examine the prospects for continuing cooperation among the members of OPEC.

USSR

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USSR

Soviet planning and budget chiefs told the Supreme Soviet on Wednesday that for the second year in a row the economy grew at a brisk pace. Major five-year-plan goals (1971-1975), however, will not be met, largely because the economy was thrown off pace in 1972 by the poor agricultural year and because of the continuing failure to complete new production facilities.

Industrial production rose, according to Soviet measures, by 8 percent in 1974, the highest rate since 1970. No details were given, but industry's success apparently resulted from uninterrupted flows of raw materials and energy, and completion of massive investment. The picture was less rosy in the agricultural sector because unfavorable weather caused farm production to fall far below the plan and last year's levels.

Soviet leaders probably are relatively satisfied with the economy's performance in 1973-1974, but next year key components of the industrial, energy, and agricultural sectors will fall far short of the original five-year-plan goals. Of the five new targets for 1975 released by Tass, four are below the originals. Moreover, by the end of next year, the consumer still will not have achieved the standard of living promised at the 24th Party Congress in 1971. Planning chief Baybakov admitted that the original consumer targets for 1975 have "proved unreachable." Indeed, Group A industries (largely producers goods) are to grow at a higher rate than Group B industries (largely consumer goods) in 1975, reversing the rates of the 1971-1975 plan.

On the wage and benefits side, the Soviet worker may fare better. In 1975 the minimum wage and pay for medium income workers will be raised, and one billion rubles of bonds--frozen since 1958--will be redeemed. Higher incomes, without a parallel rise in the supply of consumer goods, will, however, exert inflationary pressures and add to consumer frustration.

IRAN-IRAQ

The Shah of Iran has made [redacted] *decisions recently that escalate Iranian involvement in the Iraqi-Kurdish war. The way the Shah has operated since midsummer, in allowing the direct participation of Iran's military and in supplying relatively sophisticated weapons to the Kurds, indicates that he is willing to take some political and military risks to keep the rebellion going.* 25X1

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The Shah regards the Baghdad regime as the chief sponsor of political radicalism and agitation in the Persian Gulf, and as an instigator of dissident movements in Iran. His ultimate goal is to see that regime replaced by a more moderate one, or, failing this, to keep the Iraqis preoccupied with internal problems. By keeping alive the Kurdish rebellion, he increases the internal political pressures on Baghdad and ties down its military. We doubt that he wants open hostilities with Iraq or that he would commit Iranian infantry units openly to the Kurdish cause.

MEXICO

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SYRIA

President Asad weighed in yesterday with a pessimistic prognosis of the future of Middle East peace negotiations. Asad, who seldom gives interviews, told an Indian journalist that his hopes for successful political movement are not great and that the future will be fraught with "dangerous possibilities unless substantial progress is made in the coming months."

Asad reiterated in low key Syria's standard views on negotiations, ruling out "partial and unilateral settlements." He observed that war might again be necessary if political efforts fail to secure total Israeli withdrawal from Syrian territory and the achievement of Palestinian national rights. If war should break out, Syria would try to make it a long one, which "would not be in Israel's interest."

Asad's tone throughout the interview was more resigned than threatening. He did not suggest that he is at the end of his tether on negotiations nor did he press for an immediate reconvening of the Geneva conference. Instead, he said he believed Geneva could succeed when "suitable conditions become available." His words do not suggest that Syria is prepared to take the initiative in offering any new formulas for breaking the current negotiating deadlock.

PAKISTAN

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PORTUGAL

President Costa Gomes has declared that he is against participation by the military as a bloc in the constituent assembly that is to be elected next spring.

The Armed Forces Movement has been deeply divided over this issue, and the President's statement should improve the position of those members of the movement who have argued against direct participation. Most of the movement's members probably believe that they can exert considerable influence on the draft of the new constitution without participating directly.

Meanwhile, rumors of dissension within the cabinet continue to circulate in Lisbon. Sources close to Costa Gomes and Foreign Minister Soares have predicted to US diplomats that the dispute--which seems to center on the character of the new economic program--probably will be papered over. The intensity of the rumors suggests that the disagreements have been bitter, however, and may leave scars that will eventually weaken the unity of the government.

NOTES

Cyprus: President Makarios yesterday gave former acting president Clerides written instructions to begin negotiations with Turkish Cypriot Vice President Denktash on the political aspects of the Cyprus question. Clerides met with Denktash later in the day, and the US embassy in Nicosia believes that the two men will resume their negotiations. According to a Nicosia radio broadcast, the instructions are "in accordance" with the political line agreed to in Athens earlier this month by the Greek and Cypriot governments.

France: The French have announced they will begin building a nuclear-powered helicopter carrier next April. The ship, which is expected to become operational in 1980, will be assigned to escort and antisubmarine warfare missions, as well as to provide fleet air cover when carrying vertical-or-short-take-off-and-landing aircraft. [redacted] seriously considering obtaining a Super Harrier-type vertical-or-short-take-off-and-landing aircraft, possibly the Anglo-US AV-16, for the new ship. When completed, the carrier will be the first nuclear-powered surface warship in any West European navy.

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ANNEX

THE FUTURE OF OPEC OIL SUPPLIES AND PRICES

The price of oil has come to be essentially a matter of political decision and thus difficult to predict. Nevertheless, members of the Organization of Petroleum Exporting Countries have very strong incentives to stand together on the price issue.

If OPEC were to dissolve, there would be no natural floor for oil prices above the cost of production, and none of the members wants to see the return of $2-a-barrel oil. Furthermore, Saudi Arabia--the country with the greatest financial capability to cut production--has strong political reasons to conform to the desire of other Arab producers to maintain high prices.

<u>The Demand for Oil</u>

In 1975, demand for OPEC oil probably will decline. Slowing economic activity throughout the developed world will reinforce the impact of higher prices and conservation measures on consumption. The normal pattern of inventory reductions is not expected to materialize. By midsummer, demand for OPEC oil probably will fall by at least 3 million barrels per day from the current level of 29 million barrels per day. Crash conservation programs in several of the major consuming countries perhaps could create a surplus of as much as 6 million barrels per day.

After 1975, as economic recovery begins to offset the continuing impact of conservation measures, OPEC exports will probably stabilize between 26 million and 27 million barrels per day. OPEC exports will begin to fall again, however, when new oil from Alaska, the North Sea, China, and perhaps Mexico begins to enter the market in major quantities in 1978-80. By 1980, OPEC exports probably will not exceed 22 million to 24 million barrels per day.

OPEC's production policy for the near future will be to regulate output to meet demand and thus maintain the level of prices established by the group. Thus far, production cuts have been made on an individual basis, and no formal or informal production pro-rationing scheme has been agreed

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upon. OPEC countries will probably need to cut output further this coming summer, but it is not clear how the cuts will be made. What seems likely is that one or more countries will cut output outside the OPEC framework, as they did this past summer.

Similar individual moves to cut or raise output should be adequate to meet the small expected fluctuations in demand until the late 1970s. Kuwait, Libya, Iraq, the United Arab Emirates--mainly Abu Dhabi--Ecuador, and Venezuela have all shown a willingness to reduce their production substantially. Most other members also have made small voluntary production cuts.

Mammoth Surpluses

In 1975, OPEC members will have estimated surplus revenues equivalent to about 18 million barrels per day of output. If Saudi Arabia refused to cut its output next year despite an oil surplus, the other members of OPEC, with surplus revenues equal to 10 million barrels per day, could reduce output by 6 million barrels per day and still receive far more money than they could spend. The massive excess of oil revenues above import requirements places nearly all of the member states in the position of being able to reduce production substantially to maintain prices.

For the next couple of years, nearly all producers can act as price setters, with only Algeria, Ecuador, and Indonesia being forced by their import needs to act as price takers. As expenditures rise, the number of price setters will decline sharply. By the late 1970s, only Saudi Arabia, Kuwait, the United Arab Emirates, and perhaps--to a much lesser degree--Libya, Iraq, and Iran will still have the freedom to act as price setters.

During the next few years, the cartel will be able to cope with any likely oil surplus without Saudi participation, but by the late 1970s Saudi cooperation will be essential. Continuing slow growth in energy demand and rising production of energy elsewhere probably will require a formal or informal system of allocating cutbacks in OPEC states by 1978 or 1980.

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If OPEC is to succeed in holding prices high late in the decade, the OPEC core--particularly Saudi Arabia--must either reduce output much more sharply than OPEC countries as a whole, or recycle revenues to other OPEC states to facilitate their cutbacks. Although not in the position of a price setter, Venezuela will be reducing output substantially as its oil reserves are depleted.

The need for sharp cuts in output will greatly increase the influence of Saudi Arabia and Kuwait. These nations could afford to make the necessary cuts because they would still have ample financial resources. The prospect of a quantum drop in oil income if the oil producers competed in the market should serve to keep OPEC countries united. One possible OPEC response would be to raise oil prices sharply by about 1980 to recreate the flexibility to cut output still further.

Even if non-OPEC countries are highly successful in holding down growth in energy consumption and in boosting their own output of energy, they probably will still have to rely on the present members of OPEC to provide more than 20 million barrels per day of oil in 1980. Given this level of demand for OPEC oil, member countries should have no difficulty making price increases stick.

Price Policy

For the next few years, OPEC has indicated that it will probably attempt to maintain oil prices at about their current level in real terms. The cartel can be expected to raise prices periodically to offset at least part of the increase in import costs. The odds favor the adoption of some sort of price-indexing system to tie oil prices to the prices of industrial and agricultural exports.

The OPEC Secretariat and many of the more important producers support indexing, but Saudi Arabia opposes automatic price adjustments. Thus, compromise seems likely, with oil prices rising less than the cost of imports. In any event, price negotiations among the main producers will continue for years.

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As time goes on, and certainly by the late 1970s, a number of members of the Organization for Economic Cooperation and Development will have joined OPEC members in having strong vested interests in maintaining high energy prices. Developed countries like the UK probably will have protected their energy industries by establishing floor prices at high levels. Because of the large debts it is currently running up, Britain, for example, would be placed in a very difficult situation if oil prices fell sharply just as North Sea output reached substantial levels.

Among the OPEC countries, Saudi Arabia might be an exception to the general desire for high and rising prices. Such political factors as Arab unity, the Israeli occupation of Arab land, and anti-communism play a large but undefinable role in Saudi petroleum policy formulation. Outside political pressure also could be important. At the same time, there is a body of Saudi opinion favoring high prices for economic and conservation reasons, and this group appears to be growing in influence.

Although severe strains on the cohesiveness of OPEC members appear a long way off, the expected shrinkage in demand for OPEC oil over the long term gives the oil-importing nations chances to break the stranglehold on prices. Success in this endeavor will require that the importers be alert to opportunities and willing to exploit them fully through political inducements or pressures.

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